

Allocation of Controlled Group Research Credit

Notice 2013-20

PURPOSE

This notice provides interim guidance relating to the allocation of the credit for increasing research activities (research credit) to corporations and trades or businesses under common control (controlled groups) for purposes of § 41(f)(1)(A)(ii) and § 41(f)(1)(B)(ii) of the Internal Revenue Code, as amended by section 301(c) of the American Taxpayer Relief Act of 2012, P.L. 112-240, H.R. 8 (the Act), for taxable years beginning after December 31, 2011.

BACKGROUND

Under § 41(f)(1) and § 1.41-6(b) of the Income Tax Regulations, all members of a controlled group are treated as a single taxpayer for purposes of computing the research credit. Section 1.41-6(b) provides that the group credit is computed by applying all of the § 41 computational rules on an aggregate basis.

Former § 41(f)(1)(A)(ii) and former § 41(f)(1)(B)(ii) provided that the research credit allowable to a controlled group member shall be its proportionate shares of the qualified research expenses, basic research payments, and amounts paid or incurred to energy research consortiums (collectively, “QREs”) giving rise to the credit. Section 1.41-6(c)(1)(i) requires a controlled group to

allocate the group credit in proportion to each member's stand-alone entity credit, as defined in § 1.41-6(c)(2), in cases in which the group credit does not exceed the sum of the stand-alone entity credits of all of the members. If the group credit does exceed this sum, then the excess of the group credit over the sum of the stand-alone entity credits of all of the members is allocated in proportion to the QREs of the members of the controlled group. See § 1.41-6(c)(1)(ii).

Section 301(c) of the Act amended § 41(f)(1)(A)(ii) and § 41(f)(1)(B)(ii) by requiring the allocation of research credits to each controlled group member “on a proportionate basis to its share of the aggregate of the qualified research expenses, basic research payments, and amounts paid or incurred to energy research consortiums, taken into account by such controlled group for purposes of this section.” Thus, the amendments to § 41(f)(1)(A)(ii) and § 41(f)(1)(B)(ii) provide that the group credit is allocated to group members based on a member’s share of QREs, without regard to whether the member would have a stand-alone entity credit or what the amount of any such credit would be. Section 301(c) of the Act applies to taxable years beginning after December 31, 2011.

DISCUSSION

For taxable years beginning before January 1, 2012, the provisions of § 1.41-6 continue to apply in their entirety. For taxable years beginning after December 31, 2011, the provisions of § 1.41-6 continue to apply, subject to the following exceptions. First, § 1.41-6(c) shall not apply. In addition, references to § 1.41-6(c) regarding the allocation of the group credit, references to the

stand-alone entity credit described in § 1.41-6(c)(2), and the examples in § 1.41-6(e) involving the allocation of the group credit among and computation of the stand-alone entity credits for controlled group members, shall not apply.

In lieu of § 1.41-6(c), controlled groups must allocate the group credit to each member of the controlled group in proportion to each member's contribution of QREs to the controlled group's total QREs for the taxable year. Such allocation methodology must also be applied to determine the portion of a group credit that is allocated to, and within, a consolidated group that is a member of a controlled group under § 1.41-6(d)(1) and (3). For example, X, a controlled group consisting of 3 members, B, C, and D, has a \$100 credit for the taxable year. X's total QREs for the taxable year is \$1000. B paid \$200 of the QREs, C paid \$300 of the QREs, and D paid \$500 of the QREs during the taxable year. Based on the proportion of each member's contribution of QREs to the controlled group's total QREs for the taxable year, B is allocated a \$20 credit, C is allocated a \$30 credit, and D is allocated a \$50 credit.

The Treasury Department and IRS intend to revise § 1.41-6 and the examples demonstrating the allocation of the controlled group credit consistent with the allocation methodology described in this notice.

EFFECT ON OTHER CODE SECTIONS

Rules similar to the rules under § 41(f)(1) apply for purposes of § 45C, Clinical Testing Expenses for Certain Drugs for Rare Diseases or Conditions; § 45G, Railroad Track Maintenance Credit; § 45O, Agricultural Chemicals Security Credit; and § 280C, Certain Expenses for Which Credits are Allowable.

Therefore, an allocation method similar to the method required under this notice must be used for purposes of allocating credits to controlled group members under those Code sections. Specifically, see §§ 45C(d)(3), 45G(e)(2), 45O(g), and 280C(b)(3).

EFFECTIVE DATE

This notice is effective for taxable years beginning after December 31, 2011.

REQUEST FOR COMMENTS

The Treasury Department and IRS invite taxpayers to submit written comments on issues relating to this notice. Send comments to: CC:PA:LPD:RU (Notice 2013-20), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:RU (Notice 2013-20), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Submissions may also be sent electronically via the Internet to the following e-mail address:

Notice.comments@irs.counsel.treas.gov. Include the notice number (Notice 2013-20) in the subject line. Comments must be received on or before June 6, 2013. All comments will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this notice is David Selig, Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information

regarding this notice, please contact Mr. Selig at (202) 622-3040 (not a toll-free call).